

COUNTY OF MILWAUKEE
Inter-Office Communication

Date: October 17, 2002

To: Richard D. Nyklewicz, Jr., Chairman, Committee on Finance and Audit

From: Jerome J. Heer, Director of Audits
Rob Henken, Director of County Board Research

Subject: Review of Health Care Cost Reduction Plan

On Tuesday, October 8, 2002, as part of its budget hearings on the 2003 County Executive's Recommended Budget, the Finance and Audit Committee reviewed the proposed budget for Employee Fringe Benefits (org. unit 1950). At that time, the Department of Human Resources presented the major elements of a Health Care Cost Reduction Plan designed to save an estimated \$10 million from previously-projected costs for providing health care for Milwaukee County employees and retirees in 2003. The Committee voted, 7-0, to refer the matter to the Personnel Committee and the Subcommittee on Employee Insurance and Benefits, and directed the Department of Audit and County Board staff to review the plan.

Background

Milwaukee County currently provides health care to employees and eligible retirees via a health care plan with two major options. One option is a fully-insured Health Maintenance Organization (HMO) plan provided by Humana. The other option is a self-funded conventional plan administered by Wisconsin Physicians' Service (WPS). Under the HMO option, employees and retirees are restricted to care from a network of Humana providers but have no medical deductibles or co-pays and very low prescription co-pays. Under the conventional plan, employees and retirees may choose any provider but have certain medical deductibles and co-pays and prescription co-pays that are substantially higher than under the HMO option. Under the conventional plan, participants can reduce their deductibles and co-pays by limiting their choice of providers to the Health Care Network (HCN) group. HCN provides the cost controls and provider discounts to help reduce costs to employees and the County for the self-funded plan. WPS acts as the bill paying agent for the County under the self-funded plan.

In April of this year, the Department of Human Resources (DHR) held preliminary discussion with Humana regarding a potential extension of the current one-year contract for HMO services, which expires December 31, 2002. Unable to arrive at mutually agreeable terms, DHR initiated a Request for Proposal (RFP) process. In July, DHR obtained authorization from both the Subcommittee on Employee Insurance & Benefits and the Personnel Committee to reject all bids and proceed with a strategy of negotiating directly with providers for health care services.

Health Care Cost Reduction Plan

The 2003 County Executive's Recommended Budget includes \$79.5 million for fringe benefit health care, an increase of \$2.4 million (3.1%) over the 2002 budgeted amount. The \$2.4 million increase represents a projected reduction, or 'savings' of \$10 million in comparison to earlier DHR estimates of a \$12.4 million increase for 2003. The \$10 million cost reduction is projected as a result of a Health Care Cost Reduction Plan tentatively developed by DHR through the direct negotiation process approved earlier in the year by the Personnel Committee. Based on various assumptions and tentative agreements in concept with two health care providers, DHR received independent validation of the \$10 million cost reduction estimate by Milliman USA, an actuarial firm with expertise in the health care field.

Under the Health Care Cost Reduction Plan, County employees and retirees would be afforded three plan options:

- Humana HMO fully insured plan. Same benefit levels as currently provided.
- Humana Preferred Provider Option (PPO) self-insured plan. Same benefit levels as currently provided by the County convention plan administered by WPS. It is anticipated that better discounts can be achieved under Humana's nationwide PPO for retirees at out of state locations. In addition, Humana can get greater discounts from providers in Southeastern Wisconsin, as a result of its current HMO arrangements, and greater discounts on prescription drug costs.
- Aurora Exclusive Provider Option (EPO) self-insured plan. Same benefit levels as the current Humana HMO plan. This would achieve deeper discounts for the County and better benefit levels for participants than the conventional plan, but would restrict participants to the Aurora Family Network of facilities and medical personnel.

The plan includes a three-year contract with the providers, with Humana committing to a 12% premium increase for 2003 (with an additional 7% adjustment to 2004 premiums if 2003 experience warrants); a 27% maximum increase for 2004 and a 27% maximum increase for 2005, all based on the previous year's experience.

Key Assumptions

- The cost of Milwaukee County employee health care in 2003 was initially estimated to increase \$12.4 million over the 2002 budgeted amount, for an estimated cost of approximately \$89.5 million. The 2003 County Executive's Recommended Budget figure of \$79.5 million is predicated on the Health Care Cost Reduction Plan savings goal of \$10 million set against this initial estimate.

- 50% of current Conventional Plan (self-funded plan administered by WPS) will enroll in the Aurora EPO and 50% will enroll in the Humana PPO.
- Billable charges for all medical care including prescription drugs, will increase a blended average rate of 8.9% in 2003 (6.5% average increase for physicians' and facilities charges, 17% for prescription drugs).
- Enrollment in Humana HMO will remain constant at 3,857 contracts (each primary insured, whether single or family status, is considered a contract).
- Overall participation within one of the two networks (Humana PPO or Aurora EPO) will increase to 80%. Currently, 20% of retirees in the self-insured plan live outside of Southeastern Wisconsin and are not covered by the HCN network, but would have greater access to the nationwide Humana network.
- The unions representing Milwaukee County employees will approve addenda incorporating the changes. While current bargaining unit contracts allow for the County to change the third party administrator of the convention health care plan without addenda, creation of separate health care networks (i.e., Humana PPO and Aurora EPO) require such addenda.

Concerns/Challenges

- Actual cost for health care in 2002 is likely to exceed the budgeted amount of \$77.2 million. Based on our review of the Controller's projections of 2002 costs using year-to-date information and past year-end trends, 2002 costs are estimated to total approximately \$80 million. If that projection holds true, the County Executive's proposed \$79.5 million budgeted figure for 2003 represents an actual *reduction* of about \$500,000, rather than an increase of \$2.4 million, from 2002 costs.
- As of the date of this report, there were no agreed-upon contractual discounts between Aurora and Humana, an essential element of the cost savings estimate. Aurora is attempting to get higher discounts for specialists than those included in the actuary's estimate. Higher discounts would provide greater cushion to the cost projections of the actuary.
- Problems concerning the issue of 'steerage' incentives, whereby employees would be provided a reduced monthly premium in exchange for choosing either the Aurora EPO or the Humana HMO package, must be resolved for this plan to be viable. Negotiations on this point have been ongoing, but as of the writing of this memo, this issue has not been resolved to the satisfaction of all parties concerned. At this point, concern primarily relates to the unbudgeted cost (via reduced premium payments) of union workers' acceptance of the plan changes. Major factors involved in the issue of steerage include:

1. Aurora's participation in this plan initially was contingent on Milwaukee County's provision of an incentive providing reduced premiums for employees enrolling in the Aurora EPO, with reductions ranging from 10% to 50% depending upon the volume of enrollment. Aurora's ultimate goal is to maintain or increase market share, which is approximately 50% of the employees/retirees under the current Milwaukee County conventional health care plan. Aurora has since retreated from this demand, accepting in its stead a commitment on the part of the County to review participation levels at mid-year with the potential for reducing employee premiums prospectively to attain the 50% market share goal. In addition, in exchange for dropping its demand for immediate steerage incentives, Aurora obtained a 'bail-out' provision at the end of the first year of the proposed three-year contract.
 2. Conversely, Humana's participation in the plan at the currently proposed rate structure is contingent on Milwaukee County making no changes in employee premiums that place Humana HMO plan participants at a disadvantage. Therefore, any employee premium reduction applied to Aurora EPO participants would have to be offered to Humana HMO participants as well.
 3. Union sign-off is required to change the current PPO network. According to union officials, despite the improved benefit levels accruing to employees that choose the Aurora EPO in comparison to the current PPO benefit levels, this may require an incentive in the form of reduced employee premiums.
 4. The \$10 million savings attributed to the Health Care Cost Reduction Plan does not take into account any employee premium cuts. Based on reductions initially proposed by Aurora ranging from 10% to 50%, depending upon the volume of steerage accomplished, this would involve reduced revenue to the County of about \$400,000 to \$2 million in 2003. Mid-year reductions would range from about \$200,000 to \$1 million. The higher end of the ranges in these estimates assumes attainment of the 50% market share targeted by Aurora.
- As currently conceived, there is no contractual provision limiting increases in billable charges under the self-insured components of the plan (i.e., Humana PPO and Aurora EPO) to the 8.9% assumed by the actuary in endorsing the \$10 million savings estimate. In essence, this portion of the County's health plan, which accounts for an estimated \$47 million of the \$79.5 million total budgeted cost, is an agreement on discount rates. There is no agreement to lock in the billable charges against which the discount rates are applied. While the County Employee Benefits Manager told us it is unlikely that billable charges would rise significantly above the assumed blended rate of 8.9% due to market forces, there is no contractual protection for the County in this regard.
 - By duplicating the HMO benefit level for those employees enrolling in the Aurora EPO, there may be some incentive for current Humana HMO plan participants to switch to the Aurora EPO. This could potentially increase County costs, because the County assumes the full cost of care for these individuals, rather than paying a fixed premium to an HMO to assume that risk. The \$10 million savings estimate assumes no net change in the Humana HMO enrollment.

- The provision of the plan allowing Humana's 2004 premium rates to be adjusted upwards by as much as 7% (6% based on experience plus 1% interest) must be carefully designed to avoid violating Generally Accepted Accounting Principles (GAAP) that require recognition of costs in the year they are incurred. Moreover, assuming compliance with GAAP can be achieved, policy makers must decide if they wish to defer 2003 health care costs into 2004. This provision could result in additional 2004 costs of \$1.7 million in excess of what they may otherwise be, although in no event can 2004 rates exceed 2003 rates by more than the contractual limit of 27%.
- Due to normal claims filing and processing delays ('run-out'), the County will be obligated to continue paying WPS administrative charges (estimated at \$560,000) through the first several months of 2003, in addition to the administrative charges incurred by Humana for 2003 claims processing. The Health Care Cost Reduction Plan estimated savings figure of \$10 million does not take this run-out expenditure into account. According to the Controller, it may be possible under GAAP to attribute 25% of this expenditure (\$140,000) to 2002 health care costs.

Conclusions and Options

Considerable effort has been, and continues to be, directed at the development of a plan to buck the national and local trends of skyrocketing health care costs for Milwaukee County government in 2003. The Health Care Cost Reduction Plan provides great promise for holding fringe benefit health care costs lower than they would otherwise be in 2003. However, the question of whether or not the 2003 County Executive's Recommended Budget of \$79.5 million provides sufficient funding for this item is a separate matter. It should be noted that we did not include as part of our review an analysis of the specific composition of the provider networks envisioned in this plan. Based on our limited review of this evolving plan and the concerns expressed above, the County Board may wish to consider the following options.

- Ensure that the contingency fund is sufficient to address the potential for an additional \$420,000 in administrative charges for WPS to process 2002 'run-out' claims in 2003. This cost was not taken into account in either the County Executive's recommended budget amount for 2003 health care costs or in the Health Care Cost Reduction Plan savings estimate.
- Ensure that the contingency fund is sufficient to guard against possible shortfalls in the portion of the \$10 million savings attributed to self-insured components of the plan. Since the HMO component of care is 'locked in,' it is the \$5.5 million of savings attributed to care provided under the Humana PPO and the Aurora EPO components (the self-insured components) that is of primary concern. It would be prudent to include sufficient funding in the contingency fund for some portion, perhaps as much as half, of the savings estimate attributable to the self-insured components of the plan. Concerns related to the establishment of a contingency for this portion of the savings are related to:

1. The difficulty in predicting actual enrollment decisions on the part of County employees and retirees.
 2. The extent to which retirees increase their utilization of discounted network providers under the nationwide Humana PPO in comparison to the current network (HCN) which is limited to Southeast Wisconsin.
 3. The lack of a constraining contractual limitation on increases in billable charges.
- Obtain concurrence from the unions to endorse the Health Care Cost Reduction Plan without a reduction in employee premiums, or fund an additional contingency for lost revenue. The cost of reducing premiums for both union and non-union employees could range anywhere from \$200,000 to \$2 million, depending upon the size of the premium reductions contemplated and the volume of steerage realized.
 - To add a greater measure of protection from unanticipated cost increases, the County Board may wish to direct DHR to negotiate a contractual provision limiting increases in billable charges. In any event, final contract language should be reviewed by appropriate executive and legislative staff to ensure inclusion of proper termination notice, audit access and other standard County contract language.
 - Given the uncertain nature of the various assumptions upon which the 2003 County Executive's Recommended Budget for fringe benefit health care is, by necessity, built, it would be prudent for the Finance and Audit Committee to require monthly monitoring reports of actual health care costs throughout 2003.

Jerome J. Heer, Director of Audits

Rob Henken, Director of Research

cc: Supervisor Lee Holloway, Chairman, County Board of Supervisors
Supervisor Paul Cesarz, Chairman, Personnel Committee
Milwaukee County Board of Supervisors
County Executive Scott Walker
Linda Seemeyer, Director, Department of Administration
Matt Janes, Employee Benefits Manager, Department of Human Resources
Lauri Henning, Chief Committee Clerk, County Board Staff